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In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 402

J. I. CASE COMPANY, ET AL., PETITIONERS

v.

CARL H. BORAK

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE

OPINIONS BELOW

The opinion of the district court (R. 200–212) is unreported. The opinion of the court of appeals (R. 217–234) is reported at 317 F. 2d 838.

JURISDICTION

The judgment of the court of appeals was entered on May 29, 1963 (R. 235). The petition for a writ of certiorari was filed on August 26, 1963, and was granted on November 12, 1963 (R. 236; 375 U.S. 901). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, in a civil action brought by a stockholder attacking a merger allegedly procured through circulation of false and misleading proxy solicitation materials in violation of Section 14(a) of the Securities Exchange Act of 1934, a federal district court may grant relief necessary to redress the violations, or is limited to declaring the validity or invalidity of the proxy solicitation.

INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The Securities and Exchange Commission is responsible for enforcement of the Securities Exchange Act and the rules thereunder, and it reviews proxy solicitation materials prior to their distribution. The character of such review, however, is necessarily limited, and material which initially appears to satisfy the governing disclosure requirements sometimes turns out, after more intensive study by interested stockholders, to contain false and misleading information. Also, limitations of manpower prevent the Commission from bringing enforcement actions for all violations. Private actions based upon violation of the proxy rules thus are an important supplement to the Commission's own enforcement activities in accomplishing the fair corporate suffrage which the statute is designed to promote. The Commission urges affirmance of the decision below which, by upholding not only the right of a stockholder to maintain an action based on violation of the federal proxy statute, but also the authority of the federal courts to grant whatever relief is necessary to redress such

violations, sustains an important method of statutory enforcement.

STATUTES INVOLVED

Section 14(a) of the Securities Exchange Act of 1934, 48 Stat. 895, 15 U.S.C. 78n(a), provides as follows:

> It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of any national securities exchange or otherwise to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered on any national securities exchange in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Pursuant thereto the Commission has promulgated Rules 14a–1—14a–11, 17 C.F.R. 240.14a–1—240.14a–11, set forth in Appendix B to the Brief for J. I. Case Company (pp. 18–39), hereinafter referred to as the "proxy rules."

Section 27 of the Act, 48 Stat. 902, 15 U.S.C. 78aa, provides in pertinent part as follows:

> The district courts of the United States, the United States District Court for the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and

of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this title or rules and regulations thereunder, or to enjoin any violation of such title or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. * * *

STATEMENT

On November 13, 1956, respondent, a stockholder of J. I. Case Company (Case),[1] instituted this action in the United States District Court for the Eastern District of Wisconsin seeking (1) a judgment declaring a proposed merger between Case and American Tractor Corporation (ATC) illegal and void and (2) an order enjoining Case and certain of its officers and directors from acting to consummate the merger (R. 1–16). Respondent did not succeed in preventing the merger (R. 86–89) and since 1956 has filed three amended complaints seeking to undo the merger and obtain other relief (see R. 111, 160, 179). This brief will discuss the issues presented by Count Two of the

[1] J. I. Case is a Wisconsin corporation. Its securities are registered on the New York Stock Exchange (R. 24).

Third Amended Complaint (R. 196–198), which alleges violations of the Securities Exchange Act of 1934.[2]

In Count Two, respondent alleges that on October 15, 1956, petitioners solicited, or permitted the use of their names to solicit, the proxies of Case stockholders for use at a special stockholders' meeting on November 15, 1956, at which a vote was to be taken upon a proposed merger with ATC (R. 197, 182); that the proxy solicitation material was false and misleading (R. 197, 189–192) in violation of Section 14(a) of the Securities Exchange Act (*supra*, p. 3) and Rule 14a–9 thereunder (17 C.F.R. 240.14a–9) (R. 197); that the merger was approved by a small margin of votes and was consummated shortly thereafter (R. 197, 182); that the merger would not have been approved but for the materially false and misleading statements in the proxy solicitation material (R. 197, 192); and that Case stockholders were severely damaged by these violations of the statute and proxy rules (R. 197). Respondent asked the court to declare that the proxy solicitation material was false and misleading, that the proxies solicited thereby were illegal and void and that the merger and all agreements entered pursuant thereto are void. Respondent requested damages for the injury sustained by himself and all other stockholders similarly situated and "such other and further relief * * * as equity shall require" (R. 197–198). Jurisdiction was invoked un-

[2] Count One is based exclusively upon the laws of the State of Wisconsin and is not in issue before the Court.

der Section 27 of the Securities Exchange Act (*supra*, pp. 3–4), and on grounds of diversity of citizenship (28 U.S.C. 1332) (R. 196).

Case moved for an order requiring respondent to furnish security for expenses pursuant to Section 180.405(4) of the Wisconsin Statutes (Case Br. 3) and directing dismissal of the action in the event the security was not provided (R. 198–199). The Wisconsin statute authorizes such an order in actions brought "in the right of" a corporation (R. 219).

The district court ruled that the Wisconsin statute was inapplicable to a claim arising under federal law. Relying upon *Dann* v. *Studebaker-Packard Corp.*, 288 F. 2d 201 (C.A. 6), the court held that Section 27 of the Securities Exchange Act gave it jurisdiction to grant declaratory relief in a private suit alleging violation of Section 14(a), but that additional equitable relief and damages were available only under State law. Accordingly, the court concluded that these claims were subject to the State security-for-expenses statute (R. 200–212) and ordered that unless security, set in the amount of $75,000, were posted, Count Two of the complaint would be dismissed, except to the extent that it sought a declaration that the proxy solicitation material was false and misleading and that the proxies, the merger and all agreements entered pursuant thereto were void (R. 213). Upon the representation by counsel for respondent that the required security would not be posted, the district court ordered stricken those portions of the complaint seeking damages and "such other and fur-

ther relief * * * as equity shall require" (R. 214, 198).

On an interlocutory appeal under 28 U.S.C. 1292(b), the court of appeals reversed. It stated that "[t]he obvious purpose of Section 14(a) is the protection of the right of shareholders to a full and fair disclosure of all material facts which affect corporate elections by proxy" and that "the jurisdiction conferred by Section 27 must be broad enough to effectively protect that right" (R. 233). Accordingly, it held that the district court had jurisdiction to "award damages or such other retrospective relief * * * as the merits of the controversy may require" and that the claims for such relief were claims arising under federal law to which the State security-for-expenses statute was inapplicable (R. 234).

SUMMARY OF ARGUMENT

The only issue properly before the Court is whether in a private action by a stockholder attacking a merger allegedly procured through circulation of false and misleading proxy materials in violation of Section 14(a) of the Securities Exchange Act of 1934, the federal courts may grant relief necessary to redress the violations, including damages and rescission.

I

The right of a private party to sue under Section 27 for violations of Section 14(a) and the proxy rules has been repeatedly recognized, as have implied rights of action for violations of numerous other provisions of the federal securities laws. The right stems from

the general rule that where the purpose of a statute is to protect a particular class of persons, a violation will result not only in the imposition of the sanctions provided by the statute, but also in a right of action in favor of persons in the protected group who have been injured by the violation.

It makes no difference whether respondent's action is classified as a direct action for redress of injuries he has suffered or as a derivative suit for injuries to the corporation. Section 14(a) seeks to prevent persons from securing authorization for corporate action by means of inadequate disclosure. Since violations of the proxy rules may injure the stockholders both directly and indirectly through injury to the corporation, the policies which have led the courts to recognize a private right of action apply with equal force in each case.

II

The court below correctly held that the district court had jurisdiction under Section 27 to grant whatever relief might be appropriate under the circumstances of a particular case. *Bell* v. *Hood*, 327 U.S. 678, 684, makes clear that "where federally protected rights have been invaded * * * courts will be alert to adjust their remedies so as to grant the necessary relief." This Court has applied this doctrine in many situations, upholding relief other than that specified in the particular statutes involved: *i.e.*, restitution for overcharges, reimbursement for underpayments, and divestiture of acquisitions under statutes providing only for injunctive relief.

Damages and other retrospective relief are effective deterrents against violations of the proxy rules, particularly where the facts regarding violations might not be apparent until after the proxies have been voted. The fact that the relief sought might affect state-created relationships, including the possible voiding of a merger, does not deprive the federal courts of the power to grant whatever relief is appropriate to redress the violations of the proxy rules. To limit the jurisdiction of the federal courts to the granting of declaratory relief would render the private right of action under the proxy rules largely ineffective.

ARGUMENT

INTRODUCTION

This case arose upon an appeal from the district court's order dismissing that portion of the respondent's complaint which seeks relief, other than declaratory relief, for alleged violations of Section 14(a) of the Securities Exchange Act and the Commission's proxy rules. The district court held that it had no jurisdiction over these claims under federal law, that respondent's rights, if any, were dependent upon State law, and that, accordingly, the State statute requiring the posting of security for expenses was to be applied. Respondent's failure to post security led to the dismissal of those claims. The court of appeals reversed, holding that federal rather than State law governs respondent's claims for damages and other relief, and that the State statute is not applicable to such claims.

The sole question presented in the petition for certiorari was as follows (Pet. 2):

> Whether Sec. 27 of the Act grants a Federal cause of action for rescission or damages to a corporate stockholder in respect of a consummated merger which was authorized pursuant to the use of a proxy statement alleged to have contained misleading statements violative of § 14(a) of the Act.

In its brief on the merits, petitioner Case now argues (Case Br. 26–33) a further issue—whether the Wisconsin security-for-expenses statute is applicable to federally-created rights of action under the Securities Exchange Act. Since that issue was not raised in the petition, under Rule 40(1)(d)(2) of the Revised Rules of the Court,[3] and this Court's settled practice, it is not properly before the Court. We therefore express no views thereon.[4]

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[3] This Rule provides: "The phrasing of the questions presented need not be identical with that set forth in the jurisdictional statement or the petition for certiorari, but the brief may not raise additional questions or change the substance of the questions already presented in those documents. Questions not presented according to this paragraph will be disregarded, save as the court, at its option, may notice a plain error not presented."

[4] We note, however, that the decision below that the statute is inapplicable is in accord with *McClure* v. *Borne Chemical Company*, 292 F. 2d 824 (C.A. 2), certiorari denied, 368 U.S. 939, *Fielding* v. *Allen*, 181 F. 2d 163 (C.A. 2), certiorari denied *sub nom. Ogden Corp.* v. *Fielding*, 340 U.S. 817, and *Phelps* v. *Burnham*, CCH Fed. Sec. L. Rep. ¶ 91,327 (C.A. 2).

I

THE FEDERAL COURTS HAVE JURISDICTION OF A PRIVATE ACTION TO REDRESS INJURIES SUSTAINED AS A RESULT OF VIOLATIONS OF SECTION 14(a) OF THE SECURITIES EXCHANGE ACT

A. A PRIVATE PARTY MAY MAINTAIN AN ACTION BASED ON VIOLATIONS OF SECTION 14(a) OF THE SECURITIES EXCHANGE ACT

Section 27 of the Securities Exchange Act grants jurisdiction to the federal courts over violations of the Act and rules thereunder and "of all suits in equity and actions at law brought to enforce any liability or duty created [thereby]." The right of a private party to sue under Section 27 for violations of Section 14(a) of the Act and the proxy rules thereunder has been repeatedly recognized by the courts. See *Dann* v. *Studebaker-Packard Corp.*, 288 F. 2d 201 (C.A. 6); *Mack* v. *Mishkin*, 172 F. Supp. 885 (S.D.N.Y.); *Central Foundry Co.* v. *Gondelman*, 166 F. Supp. 429 (S.D.N.Y.); *Weeks* v. *Alpert*, 131 F. Supp. 608 (D. Mass.); *Rosen* v. *Alleghany Corp.*, 133 F. Supp. 858 (S.D.N.Y.); *Dunn* v. *Decca Records, Inc.*, 120 F. Supp. 1 (S.D.N.Y.); *Textron* v. *American Woolen Co.*, 122 F. Supp. 305 (D. Mass.); *Horowitz* v. *Balaban*, 112 F. Supp. 99 (S.D.N.Y.); *Doyle* v. *Milton*, 73 F. Supp. 281 (S.D.N.Y.); *Tate* v. *Sonotone Corp.*, 5 S.E.C. Jud. Dec. 310 (S.D.N.Y.); Petitioners appear to concede the existence of this right.[5]

[5] Petitioner Case (Br. 10) expressly states that it does not question that shareholders may "seek prospective relief" for such violations. The other petitioners, by urging that *Dann* v. *Studebaker-Packard Corp.*, *supra*, was correct (Barr Br. 9), make the same concession.

The right to maintain such an action rests upon the general proposition set forth by this Court in *Texas & Pacific Ry.* v. *Rigsby*, 241 U.S. 33, 39:

> A disregard of the command of the statute is a wrongful act, and where it results in damage to one of the class for whose especial benefit the statute was enacted, the right to recover the damages from the party in default is implied * * *.

This proposition has been broadly applied under the federal securities legislation. In addition to implying private rights of action for violations of the proxy requirements of Section 14(a) of the Securities Exchange Act, the courts have recognized private rights of action for violations of the margin requirements of Section 7, 15 U.S.C. 78g, and the regulations thereunder,[7] of the requirement of Section 6(b), 15 U.S.C. 78f(b), that stock exchanges adopt disciplinary procedures,[8] and, most extensively, for violations of the anti-fraud provisions of Section 10(b), 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R.

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[6] It is applied also to authorize injunctive relief. *Tunstall* v. *Brotherhood of Locomotive Firemen & Enginemen*, 323 U.S. 210. As to implied rights of action generally, see *Wheeldin* v. *Wheeler*, 373 U.S. 647, 661–662 (dissenting opinion); Restatement, Torts, Section 286; 2 Loss, *Securities Regulation* (2d ed., 1961) pp. 932–946; Note, 77 Harv. L. Rev. 285. And see *Abourader* v. *Strohmeyer & Arpe Co.*, 243 N.Y. 458, 154 N.E. 309, 311, where the court found that "[t]his rule is so general and well established that it is not subject to debate or question * * *."

[7] See *Remar* v. *Clayton Securities Corp.*, 81 F. Supp. 1014 (D. Mass.); *Appel* v. *Levine*, 85 F. Supp. 240 (S.D.N.Y.); *Reader* v. *Hirsch & Co.*, CCH Fed. Sec. L. Rep. ¶ 91,044 (S.D.N.Y.).

[8] *Baird* v. *Franklin*, 141 F. 2d 238 (C.A. 2), certiorari denied, 323 U.S. 737.

240.10b–5.[9] Implied rights of action have also been recognized for violations of provisions of other federal securities legislation.[10]

Section 14(a) of the Securities Exchange Act stemmed from the Congressional belief that "[f]air corporate suffrage is an important right that should attach to every equity security bought on a public exchange." H. Rep. No. 1383, 73d Cong., 2d Sess., p. 13. It was intended "to control the conditions under

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[9] See *Ellis* v. *Carter*, 291 F. 2d 270 (C.A. 9); *Matheson* v. *Armbrust*, 284 F. 2d 670 (C.A. 9), certiorari denied, 365 U.S. 870; *Hooper* v. *Mountain States Securities Corp.*, 282 F. 2d 195 (C.A. 5), certiorari denied, 365 U.S. 814; *Reed* v. *Riddle Airlines*, 266 F. 2d 314 (C.A. 5); *Fratt* v. *Robinson*, 203 F. 2d 627 (C.A. 9); *Errian* v. *Connell*, 236 F. 2d 447 (C.A. 9); *Eischman* v. *Raytheon Mfg. Co.*, 188 F. 2d 783 (C.A. 2); *Slavin* v. *Germantown Fire Ins. Co.*, 174 F. 2d 799 (C.A. 3); *Speed* v. *Transamerica Corp.*, 99 F. Supp. 808 (D. Del.), affirmed, 235 F. 2d 369 (C.A. 3); *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa.).

[10] Under the Investment Company Act of 1940, 54 Stat. 789, 15 U.S.C. 80a–1, *et seq.*, see *Brown* v. *Bullock*, 194 F. Supp. 207 (S.D.N.Y.), affirmed, 294 F. 2d 415 (C.A. 2); *Taussig* v. *Wellington Fund, Inc.*, 187 F. Supp. 179 (D. Del.), affirmed, 313 F. 2d 472 (C.A. 3), certiorari denied, 374 U.S. 806; *Cogan* v. *Johnston*, 162 F. Supp. 907 (S.D.N.Y.); *Schwartz* v. *Bowman*, 156 F. Supp. 361 (S.D.N.Y.), appeal dismissed *sub nom. Schwartz* v. *Eaton*, 264 F. 2d 195 (C.A. 2); *Brewick & Co.* v. *Briggs*, 136 F. Supp. 301 (S.D.N.Y.); *Brown* v. *Eastern States Corp.*, 181 F. 2d 26, 28 (C.A. 4), certiorari denied, 340 U.S. 864. But cf. *Brouk* v. *Managed Funds, Inc.*, 286 F. 2d 901 (C.A. 2), vacated as moot, 369 U.S. 424.

Under the Public Utility Holding Company Act of 1935, 49 Stat. 803, 15 U.S.C 79a, *et seq.*, see *Goldstein* v. *Groesbeck*, 142 F. 2d 422 (C.A. 2), certiorari denied, 323 U.S. 737; *Phillips* v. *The United Corp.*, 5 S.E.C. Jud. Dec. 445 (S.D.N.Y.).

Under the Securities Act of 1933, 48 Stat. 74, 15 U.S.C. 77a, *et seq.*, see *Thiele* v. *Shields*, 131 F. Supp. 416 (S.D.N.Y.).

which proxies may be solicited with a view to preventing the recurrence of abuses which * * * [had] frustrated the free exercise of the voting rights of stockholders." *Id.* at 14.[11] Although the section makes no explicit reference to a private right of action, its remedial purpose[12] indicates that persons injured by violations thereof may obtain judicial relief.

Petitioner Case urges that the "failure of Congress to provide for such an action must be interpreted as a manifestation of its intention that there should be no such action" (Br. 10) and that "the rule of *expressio unius* * * * completely negate[s] any inference that the Act was intended to create a private civil remedy for violations of Section 14(a)" (Br. 13–14). This contention is, of course, wholly at variance with Case's concession that a private right of action for prospective relief is to be implied from Section 14(a) (see n. 5, *supra*). Further, petitioner's argument would bar the rights of action which have long been recognized under the other similar sections of the federal securities laws (see cases cited, *supra*, pp. 12–13). As the Court noted in *Securities and Exchange Commission* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344, 350–351:

> [T]he ancient maxim "*expressio unius est exclusio alterius*" * * * [must be] subordinated to the doctrine that courts will construe the

[11] It had been noted: "Too often proxies are solicited without explanation to the stockholder of the real nature of the questions for which authority to cast his vote is sought." S. Rep. No. 792, 73d Cong., 2d Sess., p. 12.

[12] Cf. *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180.

> details of an act in conformity with its dominating general purpose * * * so as to carry out in particular cases the generally expressed legislative policy.[13]

The individual petitioners (Barr Br. 10; and see Case Br. 18) suggest that the present action is not based upon Section 14(a) insofar as respondent seeks to void the Case-ATC merger. They contend that the

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[13] Petitioner Case relies (Br. 12–13) upon *Nashville Milk Co.* v. *Carnation Co.*, 355 U.S. 373, and *Jacobson* v. *New York, N.H. & H.R. Co.*, 206 F. 2d 153 (C.A. 1), affirmed *per curiam* without discussion of this point, 347 U.S. 909, for its contention that Congress did not intend to create a private right of action for retrospective relief for violations of Section 14(a). However, neither case is persuasive here. The only question in *Nashville Milk* was whether Section 3 of the Robinson-Patman Act was one of the "anti-trust laws" for the violation of which the Clayton Act expressly authorizes a private suit for treble damages; this Court held that it was not. *Jacobson* was essentially an action for negligence. The court of appeals, following a long line of prior decisions (206 F. 2d at 157), held that a violation of the federal Safety Appliance Acts did not create a federal cause of action in behalf of a railroad passenger allegedly injured thereby, although the violation might well be considered in determining whether negligence under State law had been shown. The court noted that the Federal Employers' Liability Act had specifically created a right of action for railroad employees injured while employed in interstate commerce and that in such an action violation of the federal Safety Appliance Acts is treated as negligence *per se*. It held that the federal common law principle expressed in *Texas & Pacific Ry.* v. *Rigsby*, *supra*, that implied liability arises from damage to one of the class for whose benefit the statute is enacted, should not be extended to personal injury actions except for members of a class for whom express provision had been made. No such limitations on the implied liability doctrine have ever been suggested with respect to investors, such as the respondent here, who constitute the class for whose benefit the federal securities statutes were enacted.

merger can be voided only if it was a fraudulent or non-beneficial merger, and that the answer to that question is not dependent upon the allegedly invalid proxy material. Petitioners thus assert that there is no causal relationship between the proxy violations and the merger, or that the respondent may not be able to show that he was injured or that the violations are the cause of the injury. Those are questions of fact relating to relief and are to be resolved at the trial; they do not go to the jurisdiction of the court to entertain the action. The fact that they may ultimately be resolved against respondent does not deprive him of the right to assert a claim under Section 14(a). Cf. *Bell* v. *Hood*, 71 F. Supp. 813 (S.D. Cal.).

B. FEDERAL JURISDICTION ENCOMPASSES DERIVATIVE AS WELL AS DIRECT ACTIONS FOR INJURIES RESULTING FROM VIOLATIONS OF SECTION 14(a)

Citing *Howard* v. *Furst*, 238 F. 2d 790 (C.A. 2), certiorari denied, 353 U.S. 937, petitioners argue (Case Br. 14; Barr Br. 9) that respondent's action is derivative in nature, seeking recovery for injuries to the corporation, and that no such private action may be maintained for an alleged violation of Section 14(a).[14]

[14] The district court declined to dismiss Count Two of the complaint insofar as it sought a declaratory judgment not only that the proxy statement was false but also that the merger and all agreements pursuant thereto were void. The latter allegations are derivative in nature. Petitioners did not appeal from the court's refusal to dismiss this portion of the complaint. On the contrary, they urged that the order be affirmed in its entirety (Pet. Br. in Ct. of App., p. 41). In so doing, they necessarily accepted the court's recognition of the availability of a derivative action for violation of the proxy rules. Under the circumstances, this Court need not consider the question. Cf. *United States* v. *American Railway Express Co.*, 265 U.S. 425, 435.

We do not dispute the characterization of the action as derivative, at least insofar as it seeks damages and rescission. However, it makes no difference whether respondent's suit is derivative in nature or direct, for a private right of action exists in both cases.

The objective of proxy solicitation is to authorize corporate action, and the purpose of Section 14(a) and the proxy rules is to prevent management or others from obtaining such authorization by means of deceptive or otherwise inadequate disclosure. A violation of the statute may injure stockholders directly, for example, by bringing about a release of their preemptive rights, or derivatively through injury to the corporation which they own. The statutory purpose obviously justifies a remedy for all such injuries. Accordingly, the principles which have led the courts to imply liability apply with equal force whether the private action is brought by the stockholder for his direct injuries or in a derivative capacity for injuries sustained by the corporation.

In *Howard* v. *Furst, supra,* the court of appeals held otherwise. It reasoned that a derivative action is one to enforce a right of a corporation and that, since Section 14(a) regulates solicitation of proxies from stockholders "for the protection of investors," it does not create any rights in the corporation as distinct from its individual stockholders.[15] However,

[15] The court may have been influenced not so much by this conceptual reasoning as by a belief that, since the defendant directors there owned more than 60 percent of the stock, proxy solicitation was something of a formality having little relation to the essential issues.

"the protection of investors" requires redress not only against conduct which injures them directly without affecting their underlying equity in the corporation, but also against conduct which results in injury to their interest in the corporation. In each case the injury is to the investors and in each case they are entitled to redress as part of the protection afforded under Section 14(a). When Congress provided in Section 14(a) for the regulation of the proxy mechanism "in the public interest," it obviously intended that the words of the statute be read broadly in accordance with its remedial purpose and not in the limited and technical fashion in which the court approached the proxy provision in *Howard* v. *Furst*, *supra*.

The distinction drawn in *Howard* v. *Furst* was not accepted in *Hoope* v. *Mountain States Securities Corp.*, 282 F. 2d 195, 201–202 (C.A. 5), certiorari denied, 365 U.S. 814. There the court held that an issuing corporation could recover under Section 10(b) of the Act and Rule 10b–5 thereunder for fraud in the issue and sale of its securities. In so doing it characterized the argument that an issuing corporation is not an "investor" for whose protection the rule was adopted, as an "artificial application of the concept that violation of a legislative standard gives those intended to be protected a private right of action provided the injury sustained is other than that suffered by the public generally." It went on to explain that the "broad purpose" of the securities laws was to prevent fraudulent schemes and other evils in the

securities field and that protection of an issuing corporation from such frauds was within the "public interest" standard of the Act. Similarly, it is in the public interest that stockholders be permitted to redress injuries resulting from violation of the proxy rules, even though they seek such redress derivatively on behalf of their corporation.

The distinction between a "derivative" and an "individual" cause of action is unenlightening in the context of proxy solicitation. As was pointed out in *Dann* v. *Studebaker-Packard Corporation*, 288 F. 2d 201 (C.A. 6), with reference to an implied cause of action under the proxy rules, the determination whether this is a derivative or an individual action depends upon whether emphasis is placed on the "right violated" which is individual or upon the "damage which resulted" which that court classified as derivative. The court characterized analysis in terms of this distinction between "derivative" and "individual" rights of action as "* * * merely legal formalisms in which the Court elects to clothe its choice of the underlying policy considerations upon which the real basis for decision must rest" (*id.* at 211). The injury suffered by a stockholder as a result of corporate action consummated pursuant to a misleading proxy solicitation is almost invariably a result of injury suffered by the corporation, rather than damage inflicted directly upon him. Indeed, any damage he suffers results not so much from the fact that he was deceived into giving his own proxy, but rather

from the fact that a majority of the other stockholders were similarly deceived.[16] Consequently the "underlying policy considerations" here involved are really whether or not stockholders so injured may obtain a meaningful remedy. To this we now turn.

II

IN A PRIVATE SUIT ALLEGING INJURY FROM VIOLATIONS OF SECTION 14(a) OF THE SECURITIES EXCHANGE ACT, A FEDERAL DISTRICT COURT HAS JURISDICTION UNDER SECTION 27 OF THE ACT TO GRANT WHATEVER RELIEF MAY BE APPROPRIATE

Both courts below and, indeed, the petitioners recognized that a private right of action may arise from violations of the proxy rules. The real controversy was whether federal jurisdiction in such a case is limited to claims for declaratory relief. The court of appeals properly held that there is federal jurisdiction under Section 27 "to award damages or such other retrospective relief to the plaintiff as the merits of the controversy may require" (R. 234). No other ruling would be consistent with the broad grant of jurisdiction in Section 27 of the Act over "all suits in equity and actions at law brought to enforce any liability or duty created [thereby]" or with the decisions of this Court.

Thus, the Court stated the governing principle in

[16] Even if a particular stockholder is not deceived and votes against a proposal, his injury will be the same if a majority of his fellow stockholders are misled into authorizing injurious action.

Sola Electric Co. v. *Jefferson Electric Co.*, 317 U.S. 173, 176:

> When a federal statute condemns an act as unlawful, the extent and nature of the legal consequences of the condemnation, though left by the statute to judicial determination, are nevertheless federal questions, the answers to which are to be derived from the statute and the federal policy which it has adopted. * * *

Accord: *Tunstall* v. *Brotherhood of Locomotive Firemen & Enginemen, supra,* 323 U.S. at 213; *Deitrick* v. *Greaney,* 309 U.S. 190, 201. *Bell* v. *Hood,* 327 U.S. 678, 684, made clear that the federal courts have the power to fashion whatever relief may be necessary in the particular circumstances: "[I]t has been the rule from the beginning" that "where federally protected rights have been invaded * * * courts will be alert to adjust their remedies so as to grant the necessary relief." In our view, these cases are dispositive of the issue presented here.

Petitioner Case suggests that *Bell* v. *Hood* is inapplicable to the present case because it involved "a 'general grant of jurisdiction' to the courts to enforce" a federal statute, whereas Section 27 of the Exchange Act is "merely a designation of the forum" (Case Br. 15). Such a restrictive interpretation of Section 27, however, is contrary to the views expressed in *Deckert* v. *Independence Shares Corp.,* 311 U.S. 282, with respect to a comparable provision of the Securities Act of 1933. The question there was whether the Securities Act "authorizes purchasers of securities to maintain a suit in equity

to rescind a fraudulent sale and secure restitution of the consideration paid, and to enforce the right to restitution against a third party where the vendor is insolvent and the third party has assets in its possession belonging to the vendor." 311 U.S. at 284. Relying upon Section 22(a) of the Securities Act, 15 U.S.C. 77v(a), which, like Section 27 of the Exchange Act, gives federal courts jurisdiction over "all suits in equity and actions at law brought to enforce any liability or duty created" by the Act and rules thereunder, the Court held that there was jurisdiction to grant the relief requested. 311 U.S. at 290. With respect to Section 22(a), the Court stated (311 U.S. at 288):

> The power *to enforce* implies the power to make effective the right of recovery afforded by the Act. And the power to make the right of recovery effective implies the power to utilize any of the procedures or actions normally available to the litigant according to the exigencies of the particular case. * * *

The fact that the *Deckert* case involved a statutory provision which in terms created liability to private parties, while the instant claims are based upon an implied liability, provides no valid distinction insofar as the court's jurisdiction to grant relief is concerned. In both cases the liability arises under federal law, and the statutory grant of federal jurisdiction to enforce any liability is identical and unrestricted.

The holding in *Bell* v. *Hood*, 327 U.S. 678, 684, that "federal courts may use any available remedy to make good the wrong done" has been applied in

many situations and the availability of the remedy has never been dependent upon its specification in the statute involved. Thus, in *Porter* v. *Warner Holding Co.*, 328 U.S. 395, the Court held that the absence of a specific statutory provision permitting the courts to order restitution of rents collected in excess of the permissible maximum did not deprive a district court of its equitable jurisdiction to order such restitution in an action by the Price Administrator to enjoin violations of the Emergency Price Control Act of 1942. The Court stated (*id.* at 398) that only with the power to grant "whatever * * * relief may be necessary under the circumstances * * * can equity do complete rather than truncated justice." It added: "Unless a statute in so many words, or by a necessary and inescapable inference, restricts the court's jurisdiction in equity, the full scope of that jurisdiction is to be recognized and applied." Similarly, where the Secretary of Labor sued to enjoin violations of the Fair Labor Standards Act of 1938, it was held that a federal district court had jurisdiction to order reimbursement for losses of wages caused by a violation of the Act, even though there was no specific provision in the statute contemplating such relief. *Mitchell* v. *Robert DeMario Jewelry, Inc.*, 361 U.S. 288. The Court stated (*id.* at 291–292): "* * *. When Congress entrusts to an equity court the enforcement of prohibitions contained in a regulatory enactment, it must be taken to have acted cognizant of the historic power of equity to provide complete relief in light of the statutory purposes." See also *Schine Chain*

Theatres, Inc. v. *United States*, 334 U.S. 110, where no jurisdictional objection was found, in an action based upon Sections 1 and 2 of the Sherman Act, to a district court order requiring divestiture of certain properties, notwithstanding the silence of the Act with respect to such a remedy. The Court noted (*id.* at 128) that divestiture was "an equitable remedy designed in the public interest to undo what could have been prevented had the defendants not outdistanced the government in their unlawful project."

The principles recognized in the foregoing cases had been applied in actions based upon violations of the proxy rules long before the decision of the court below.[17] Indeed, whether the action be brought by the Commission or by private parties, it is only through application of such principles that the "reasonably complete and effective" control and regulation contemplated by Section 2 of the Act (15 U.S.C. 78b) will be afforded. Private enforcement of the proxy rules provides an important supplement to the necessarily limited enforcement activities of the Commission. In our view, the possibility of civil damages or other relief serves as an effective deterrent against

[17] See *Securities and Exchange Commission* v. *Transamerica Corp.*, 163 F. 2d 511, 518 (C.A. 3), certiorari denied, 332 U.S. 847; *Mack* v. *Mishkin*, 172 F. Supp. 885, 889 (S.D. N.Y.). For applications of these principles in other cases arising under the federal securities laws see, *e.g.*, *Aldred Investment Trust* v. *Securities and Exchange Commission*, 151 F. 2d 254, 261 (C.A. 1), certiorari denied, 326 U.S. 795; *Securities and Exchange Commission* v. *Los Angeles Trust Deed & Mortgage Exchange*, 186 F. Supp. 830, 838–839 (S.D. Cal.), modified, 285 F. 2d 162, 182 (C.A. 9).

proxy violations and may be particularly helpful in instances where the facts regarding the violation do not become apparent until after the proxies have been voted and where criminal sanctions do not appear to be indicated. The Commission's administrative function under the proxy rules is limited to examination of proxy solicitation material prior to its circulation. See Rule 14a–6, 17 C.F.R. 240.14a–6. The Commission examines over 2,000 proxy statements a year,[18] and Rule 14a–6 contemplates that the Commission's examination will have been completed within a ten-day period so that the solicitor may proceed to distribute the material. Ordinarily the Commission cannot make an independent investigation into the facts set forth in solicitation material and must take all statements contained therein at their face value unless they are inconsistent with prior material filed with the Commission. Hence, cases may well arise where proxy solicitation material appears proper on its face but may prove to be misleading on the basis of facts unknown to the Commission.[19]

[18] See, *e.g.*, 28 SEC Ann. Rep. 58; 27 SEC Ann. Rep. 71.

[19] On the facts alleged in respondent's complaint, the instant case presents a good example of this type of situation. The alleged misleading nature of the proxy material resulted in part from a failure to disclose claimed unlawful market manipulations of the stock of ATC, the company with which Case was to be merged (R. 185, 192). Until a violation of the anti-manipulative provisions of the Securities Exchange Act became known following the merger, violations of the proxy rules in this respect would not have been apparent.

Petitioner Case refers to the fact that the "[p]roxy material describing the proposed merger was not challenged by the Securities & Exchange Commission" (Case Br. 4). Examination of

There is no merit to petitioners' argument that retrospective relief—rescission—is "so obviously completely determinable and remediable under non-federally based common law" that the federal courts have no jurisdiction to award such remedies even where appropriate (Barr Br. 9; Case Br. 19–20).[20] Essentially, petitioners' contention is the one accepted by the Sixth Circuit in *Dann* v. *Studebaker-Packard Corp.*, 288 F. 2d 201,[21] that the "preponderance of questions of state law which would have to be interpreted and applied in order to grant the relief sought * * * is so great that the federal question involved * * * is really negligible in comparison" (288 F. 2d at 214).[22] But overriding federal law may re-

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such material by the staff of the Commission and its failure to object thereto is not to be regarded as approval and should have no effect upon a subsequent private suit based upon the material. See Section 26 of the Act, 15 U.S.C. 78z; *Subin* v. *Goldsmith*, 224 F. 2d 753, 767, 774 (C.A. 2); *Securities and Exchange Commission* v. *Henwood*, CCH Fed. Sec. L. Rep. ¶ 91,125, at p. 93,713–7, modified on other grounds, 298 F. 2d 641 (C.A. 9), certiorari denied, 371 U.S. 814; *Union Pacific R.R. Co.* v. *Chicago and North Western Ry. Co.* (N.D. Ill., No. 63–C–2051, February 18, 1964).

[20] There is, of course, no issue here as to the appropriate form of relief in this case. Questions whether damages should be awarded to respondent or whether the Case-ATC merger should be overturned or declared void have not yet been reached. Indeed, it has not been determined whether respondent is entitled to any relief.

[21] This holding has been the subject of criticism. See 2 Loss, *Securities Regulation* (2d ed., 1961) Supp., 1962, pp. 20–23; 75 Harv. L. Rev. 637; 62 Col. L. Rev. 375; 1962 Duke L. J. 151, 161; 9 U.C.L.A. L. Rev. 232. Compare 112 U. Pa. L. Rev. 456 (comment on the instant case).

[22] The court stated that were it to determine the effects of invalid proxies it would be faced with such questions of state law

quire redress irrespective of the provisions of State corporation law. In determining the appropriateness of such relief, "[i]t is not uncommon for federal courts to fashion federal law where federal rights are concerned." *Textile Workers* v. *Lincoln Mills*, 353 U.S.

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as "the participating quorum necessary to transact the business under consideration and thereby to make the election a valid one; the voting majority necessary to determine the issue voted upon; does this mean a majority of all stockholders or merely a majority of the participating quorum; what is the scope and effect of the *de facto* doctrine as affecting proxies declared invalid under federal law?" 288 F. 2d at 214.

Petitioner Case attempts to provide additional reasons why federal jurisdiction should not encompass the type of relief sought in the present case by suggesting various problems that would result from the "unwarranted extension of Federal jurisdiction" (Case Br. 10) over matters traditionally governed by State law (Case Br. 19–25). We have already seen, however, that petitioner does "not question the private right of shareholders under the Act, in addition to the rights of the Commission, to seek prospective relief of injunction * * *" where a materially false and misleading proxy statement has been used (Case Br. 10). Nor does petitioner seem to quarrel with the long line of cases according restrospective relief to private parties for violations of Section 10(b) of the Act and Rule 10b–5 thereunder (see n. 9, *supra*). Nevertheless, substantially all of the difficulties petitioner forsees would be presented by application of the foregoing propositions. For example, the problems suggested (Case Br. 21) with respect to the applicable statute of limitations and the state security-for-expenses statutes have already been determined in actions under Rule 10b–5. See, *e.g.*, *Errion* v. *Connell*, 236 F. 2d 447, 455 (C.A. 9) (statute of limitations); *McClure* v. *Borne Chemical Co., Inc.*, 292 F. 2d 824 (C.A. 3), certiorari denied, 368 U.S. 939 (security for expenses). As to the interference with the internal affairs of corporations (Case Br. 10), there would seem to be little difference in the extent of interference between an action to postpone a corporate meeting and require resolicitation of proxies (see, *e.g.*, *Securities and Exchange Commission* v. *Transamerica*

448, 457; *Union Pacific R. Co.* v. *Chicago and North Western Ry. Co.* (N.D. Ill., No. 63-C-2051, February 18, 1964). The fact that questions of State law might have to be decided, however, in determining the relief to be awarded to redress injuries caused by the invalid proxies in no sense establishes that the right to redress is a State rather than a federal right. On the contrary, the principles stated in *Bell* v. *Hood, Sola Electric Co.,* and *Deckert,* establish that the federal right implied from Section 14(a) is a right to all appropriate relief.

Gully v. *First National Bank,* 299 U.S. 109, on which petitioners and the Sixth Circuit in *Dann* rely, is not to the contrary. The issue there was whether an action brought by a State tax collector to enforce an assessment of a state tax against a national bank was a suit arising "under the Constitution or laws of the United States," within the meaning of the Judicial Code. In holding that the case did not so arise, the Court determined that the plaintiff's cause of action was based wholly on State law and that the federal statute relied upon (the statute authorizing States to tax national banks) did not confer the right, but merely withdrew a possible defense, and that it was not apparent that there was any actual controversy concerning the federal law. This Court concluded that "[t]he most one can say is that a question of federal law is lurking in the background." 299 U.S.

Corp., 67 F. Supp. 326 (D. Del.), modified and affirmed, 163 F. 2d 511 (C.A. 3), certiorari denied, 332 U.S. 847), and one seeking damages or other relief after the proxies obtained in violation of the rules have been voted.

at 117. In the present case, however, the essence of the claims are the alleged violations of the federal proxy rules, and as in *Bell* v. *Hood, supra,* 327 U.S. at 683, they "form * * * the sole basis of the relief sought." Here, the most petitioners could say is that there are questions of State law lurking in the background.

Even if questions of State law must be decided in order to determine the specific results which should follow from a violation of federal law, this does not provide a reason to refuse to determine these results. See, *e.g., United Fuel Gas Co.* v. *R. R. Commission,* 278 U.S. 300, 307; *Risty* v. *Chicago, Rock Island & Pacific Ry. Co.,* 270 U.S. 378, 387; *Osborn* v. *Bank of the United States,* 9 Wheat. 738. In *Osborn,* where it was contended that the action did not arise under a law of the United States because several questions might have involved local law, Chief Justice Marshall stated (9 Wheat. at 819–820):

> If this were sufficient to withdraw a case from the jurisdiction of the federal courts, almost every case, although involving the construction of a law, would be withdrawn; and a clause in the constitution, relating to a subject of vital importance to the government, and expressed in the most comprehensive terms, would be construed to mean almost nothing.

If federal jurisdiction were limited to the granting of declaratory relief, investors would often have to go into the courts of the State, where the transaction for which the proxies were solicited had been consummated, in order to obtain meaningful redress for

violations of Section 14(a) of the Securities Exchange Act. If the law of a particular State should attach no substantive consequences to the use of a misleading proxy statement, the result might well be to leave the investors without any remedy. Efforts of the State court to fashion a remedy to fill the void might be met with the argument that this is contrary to Section 27 which confers exclusive jurisdiction of violations of the Act on the federal courts.[23]

Even where State law affords a remedy, there would be no certainty that the injured investors could obtain redress. Whether a plaintiff would be forced to prosecute separate suits, as contemplated in *Dann*, or could assert jurisdiction on the basis of diversity of citizenship, application of restrictive State statutes such as the security-for-expenses statute involved in the present case[24] might well leave him with an empty declaratory judgment. Without the benefit of the broad venue and nationwide service of process provisions of Section 27 of the Act, a plaintiff who was "successful" in the federal court could find it impossible to bring before a State court all parties necessary to the complete relief.[25] Indeed, the very "horrors of split, or piecemeal, litigation" referred to in *Dann* (288 F. 2d at 214) could alone discourage the bringing of

[23] Cf. *Mekrut* v. *Gould*, 188 N.Y.S. 2d 6, 9 (Sup. Ct., N.Y. County); *American Distilling Co.* v. *Brown*, 51 N.Y.S. 2d 614, 616–617 (Sup. Ct., N.Y. County); *Standard Power & Light Corp.* v. *Investment Associates, Inc.*, 51 A. 2d 572, 579 (Del. Sup. Ct.).

[24] Cf. *Chabot* v. *Empire Trust Co.*, 301 F. 2d 458, 461 (C.A. 2); Hornstein, *The Death Knell of Stockholders' Derivative Suits in New York*, 32 Calif. L. Rev. 125.

[25] Cf. *Hooper* v. *Mountain States Securities Corp.*, 282 F. 2d 195, 198 (C.A. 5), certiorari denied, 365 U.S. 814; *Phillips* v. *The United Corp.*, 5 S.E.C. Jud. Dec. 445, 471–472 (S.D. N.Y.).

private actions for violations of Section 14(a) once the proxies had been used to accomplish their purpose.

Petitioners place great stress on the allegedly extreme and disruptive consequences which would result if federal jurisdiction exists to order rescission of a merger (Case Br. 23–25).[26] Although we believe that federal courts have power to grant this remedy if they determine that this is necessary,[27] we believe that other available relief may normally be more appropriate. This would include damages or readjustment of the terms of the merger to eliminate inequities in the allocation of securities among the participants. Respondent alleges that such inequities existed in this case and, in violation of the proxy rules, were concealed. On the other hand, rescission of a merger might be appropriate, for example, where a corporation, wholly owned by violators of the proxy rules, has merged with a publicly owned company or where a merger is the product of an illegal conspiracy between the corporate managements involved and there are no intervening equities. In this case we are concerned only with the existence of federal jurisdiction and not with the determination of the appropriate remedy, which must await trial on the merits.

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[26] Petitioners presumably do not question the jurisdiction of State courts to upset mergers where State law is violated. It does not appear how federal jurisdiction to upset a merger would be any more disruptive than State jurisdiction to do so.

[27] Compare *The Chicago Junction Case*, 264 U.S. 258, where this Court held that an action lay to set aside a completed acquisition by the New York Central Lines of the stock of the Chicago River and Indiana Railroad, as well as a lease entered into by the latter company. There it was alleged that the order of the Interstate Commerce Commission authorizing these transactions had not been supported by evidence.

CONCLUSION

For the foregoing reasons the judgment of the court of appeals should be affirmed.

Respectfully submitted,

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